APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1969

No. 28789

D. C. Docket No. CA 68-1-EC
CESAR E. ALVAREZ, ET UX,
Plaintiffs-Appellees,

versus

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of Florida

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Before JONES, WISDOM and COLEMAN, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby reversed; and that this cause be, and the same is hereby remanded to the said District Court in accordance with the opinion of this Court.

It is further ordered that plaintiffs-appellees pay to defendant-appellant, the costs on appeal to be taxed by the Clerk of this Court.

Issued As Mandate: September 1, 1970

IN THE
UNITED STATES COURT OF APPEALS
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No. 28789

CESAR E. ALVAREZ, ET UX,
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Appeal from the United States District Court for the Southern District of Florida

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(September 1, 1970)

Before JONES, WISDOM and COLEMAN, Circuit Judges.

JONES, Circuit Judge: Cesar Alvarez and his wife, Ana, filed income tax returns for the years 1961, 1962 and 1963. In 1964 and 1966 they filed claims for refund, asserting overpayments for the taxable years 1962 and 1963 in the amounts of $65.00 and $416.00. The Commissioner of Internal Revenue disallowed the claims and this action

was brought in the district court to recover the amounts paid. Ana Alvarez was a party to the suit and is a party here because, as the wife of Alvarez, she joined in the filing of joint returns. The district court decided the case in favor of the taxpayers and entered a judgment for them. The United States has appealed.

Prior to 1961, Cesar Alvarez was a Cuban National residing in Cuba. He owned improved business property in Camaguey, Cuba, which was rented in several parcels to different tenants. On October 14, 1960, the Cuban Government enacted the Urban Realty Reform Law. By this law, the State of Cuba took almost all urban rental property, including that of Alvarez. The law provided for indemnification to the former owners of rental property in an amount established by formula and the only requirement for indemnification was the making of a declaration by a former owner of the property which he owned and on which he collected rent.

Alvarez made the necessary declaration and was awarded a total indemnification of $22,400.00 payable at the rate of $200.00 per month. He received eight monthly installments from October 31, 1960 to May 31, 1961. On June 6, 1961, Alvarez left Cuba and entered the United States. Prior to this date he had made several trips to the United States to visit the members of his family who had moved to Florida in November 1960. Alvarez became a resident alien and acquired the status of a United States taxpayer on July 6, 1961. Monthly indemnification checks were made out to Alvarez and delivered to his bank in Cuba until December 1961. These installments were not received by Alvarez since his physical presence was necessary to obtain the checks.

The Cuban Government, on December 5, 1961, enacted Law No. 989 providing for the total confiscation of property in Cuba, of whatever nature, owned by Cuban Nationals who failed to return to Cuba within a designated time. Alvarez did not return and thus he ceased to be entitled, under the Cuban law, to receive payments of indemnification, both those which had accrued and thereafter to accrue, for the 1960 taking of his property.

In his claims for refund, Alvarez alleged that his interest in the property owned by him in Cuba had been taken on December 5, 1961, after he had become a resident alien, and that this loss was deductible under Section 165 of the Internal Revenue Code of 1954[1] as a loss of property used in his trade or business and that he was entitled to a net operating loss carryover[2] to 1962 and 1963. The Government contends that if there was a loss, it was sustained by Alvarez before he became a resident alien and it is therefore not an allowable loss within the meaning of Section 165 of the Internal Revenue Code. The Government takes the position that because of the difficulties which Alvarez would encounter in realizing upon his right to indemnification after leaving Cuba and before becoming

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[1]The relevant portions of this section of the Code provide as follows:

"(a) General Rule. — There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

. . .

"(c) Limitation on Losses of Individuals. — In the case of an individual, the deduction under subsection (a) shall be limited to —

(1) Losses incurred in a trade or business . . . "

28 U.S.C.A. § 165(a) and (c)(1).

[2]See 28 U.S.C.A. § 172.

a resident alien, he had lost the right which would have been open to him if he could have presented himself at his bank in Cuba to receive and cash the indemnification checks. If Alvarez sustained a loss of his Cuban property and property rights before he became a resident alien, the loss would not be allowable as a deduction.[1]

Although it would have been necessary for Alvarez to return to Cuba in order to obtain and cash the indemnification checks issued to him and sent to his bank, the right existed and was recognized by the Cuban Government, which was performing its undertaking to make payments. The checks which had been issued were payable to him and the right of indemnification continued. This was not, in the existing situation, any condition or state of hopelessness of recovery so as to constitute, within the meaning of the tax law, a loss of his right to indemnification. See *Estate of Fuchs v. Commissioner*, 2d Cir. 1969, 413 F.2d 503; *Harry J. Colish v. Commissioner*, 48 T.C. 711. At the time Alvarez became a resident alien he had, in our opinion, property rights consisting of the obligations of the Cuban Government in its promise of indemnification and in the checks which had been issued to him as payee and delivered to his bank in Cuba.

It is not necessary, for the purposes of this opinion, to determine whether Alvarez sustained a loss at the time of the taking of his real property in Camaguey, but, if he did then sustain a loss, it was a loss of the difference between his adjusted basis in the property and the value of his right to indemnification. Such loss, if any, would play no part in the computation of any income taxes pay-

[1]See 26 U.S.C.A. § 873; Treas. Reg. 1.871-1; David Schnur v. Commissioner, 10 T.C. 208; Houdry v. Commissioner, 7 T.C. 666.

able to the United States since it occurred prior to the time in which Alvarez became a resident alien.[4]

The controlling issue on this appeal is whether Alvarez sustained a loss by reason of the confiscation of the unused checks and the remaining value of his right of indemnification resulting from Law No. 989; and, if he did thereby sustain a loss, was it a trade or business loss under Section 165(c) entitling him to have such loss allowed in the computation of his tax liability for 1961 and the subsequent carryover years.[5] Alvarez had property and property rights in Cuba after becoming a resident alien and before the effective date of Law No. 989. There can be no doubt that this law divested him of his property and property rights, resulting in a loss to him.

At the time when the Cuban Government took the rented real property of Alvarez, he was divested of trade or business property and for this property there was substituted the non-interest bearing obligation of the Cuban Government. There was a conversion of one kind of property into that of another kind. All of the charac-

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[4]Id.

[5]It should be noted that for Alvarez to receive any tax benefit by way of a deduction and carryover of his loss, the loss must be characterized as one incurred in his trade or business. The loss cannot be deducted under Section 165(c)(3) of the Code because the Internal Revenue Service has taken the position, and the Tax Court has agreed, that, in the absence of special legislation, a loss by way of confiscation under color of legal authority is neither a casualty nor a theft. William J. Powers v. Commissioner, 36 T.C. 1191, I.T. 4086, 1952-1 Cum. Bull. 29. Similarly, if the loss is characterized as one incurred in a transaction entered into for profit under Section 165(c)(2), a deduction for such loss cannot be a part of a net operating loss carryover. 28 U.S.C.A. § 172(c), (d)(4); Treas. Reg. § 1.172-3(a)(1), (a)(2), and (a)(3)(ii-iii). A Section 165(c)(2) loss may be utilized in determining a "net operating loss" deduction only to the extent of nonbusiness income in the year of loss. 28 U.S.C.A. § 172(d).

teristics of finality were present. No profit could have resulted from the ownership of the right of indemnification. Thus the loss sustained does not meet the profit motive test to qualify it as a trade or business loss. See 5 Mertens, Law of Federal Income Taxation, § 28.31, 130-31. The Cuban promise of indemnification was an obligation for the payment of money, nothing more or less. The obligation received did not have the trade of business attributes of the property for which it was received even though the conversion was involuntary. The trade or business attribute cannot attach to the right of indemnification by the application of a doctrine of relation back to the trade or business property for which the indemnification was given. Situations in which there has been a relation back to prior transactions in earlier tax years to determine the taxable nature of a subsequent transaction have been cases where the subsequent transaction was an amendment or modification of the original one. See **Arrowsmith v. Commissioner**, 344 U.S. 6, 97 L.Ed. 6, 73 S.Ct. 71; **Wener v. Commissioner**, 9th Cir. 1957, 242 F.2d 938; **Commissioner v. Adam, Meldrum & Anderson Company**, 2d Cir. 1954, 215 F.2d 163; **Duveen Brothers, Inc. v. Commissioner**, 2d Cir. 1952, 197 F.2d 118. Here, the confiscation of the right of indemnification and other intangibles was related to the earlier taking only in that the fruit of the first was the subject of the second. This is not enough. The 1961 law did not in any way amend, modify, or even relate to the earlier law. Rather, Law No. 989 spoke to a different situation, namely, the property of Cuban absentees.

It is contended by Alvarez that the taking of his real estate by the Cuban Government in 1960 and the giving to him of a right of indemnification constituted an install-

ment sale and that he was entitled to treat the confiscation of his right of indemnification as a loss under Section 453(d)(1).[6] It is doubtful that the taking of Alvarez' property could be regarded as an installment sale within the meaning of the provision of the Code. But, whether so or not, Alvarez did not bring himself within the provisions of Section 453 through compliance with the election requirement of that statute, **Marcello v. Commissioner**, 5th Cir. 1967, 380 F.2d 499, cert. den. 389 U.S. 1044, 19 L.Ed.2d 835, 88 S.Ct. 787. The taxpayer's contention is plausible, but we think it must be rejected.

We are aware of decisions by other courts involving questions similar to those which are here presented,[7] including a case in which it was held that losses similar to that sustained by Alvarez are trade or business losses.[8] However, the conclusion that a loss such as was sustained

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[6]"(d) Gain or loss on disposition of installment obligations. —

(1) General rule. — If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and —

(a) the amount realized, in the case of satisfaction at other than face value or a sale or exchange, or

(b) the fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of distribution, transmission, or disposition otherwise than by sale or exchange.

Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received."

26 U.S.C.A. § 453(d)(1).

[7]Luis Bosch v. Commissioner, T.C. Mem. 1970-66; Vila v. United States, S.D. Fla.1969, 301 F.Supp. 1004; Garrigo v. United States, N.D. Tex.1968, 296 F.Supp. 1110.

[8]Beltran v. Commissioner, 69-2 USTC 85,752. Appeal pending, 7th Cir.

by Alvarez is a trade or business loss is not the better view. We believe that a contrary result must be reached. The case of Luis Bosch, now pending on appeal before this Court,[1] involves a somewhat different issue than is presented by this case.

Since we decide this case, which seems to be one of first impression in this Court, on the ground that the right of indemnification was not property held for trade of business, it is unnecessary to give consideration to the other questions presented. The judgment of the district court will be reversed and cause remanded for entry of an appropriate judgment in keeping with this opinion.

REVERSED AND REMANDED.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

No. 68-1-Civ-EC

CESAR E. ALVAREZ and ANA I. ALVAREZ,
Plaintiffs,

vs.

UNITED STATES OF AMERICA,
Defendant.

Filed June 27, 1969

[1]Bosch v. C.I.R. No. 30152, 5th Cir., July 20, 1970.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on for trial pursuant to due notice and upon consideration of the evidence presented to the court without a jury and upon memoranda of law, pretrial stipulation, and argument of counsel, the court finds as follows:

FINDINGS OF FACT

1. This is an action brought by the plaintiffs for the refund of income taxes for the taxable years 1962 and 1963. For each of these years, the plaintiffs timely filed income tax returns and paid income taxes of Sixty-five dollars ($65.00) in 1962 and Four hundred sixteen dollars ($416.00) in 1963. On December 28, 1964, the plaintiffs claimed a refund for the sum of Four hundred sixteen dollars ($416.00) and on April 11, 1966, a refund claim was filed for the year 1962 in the amount of Sixty-five dollars ($65.00). Both claims were filed on Government Form 843. On January 25, 1966, the claim for refund for 1963 was denied with full disallowance and on November 16, 1966, the claim for refund for 1962 was denied with full disallowance and this suit followed.

All jurisdictional prerequisites to bring this suit have been met, and this court has jurisdiction over the parties and the subject matter of this litigation.

2. The basis for recovery, as claimed by the plaintiffs, is an operating loss totaling Thirty-five thousand dollars ($35,000.00), by virtue of the expropriation of the plaintiffs' business property by Cuban Government under

Law #989, enacted on December 5, 1961. Law #989 provided for total confiscation without compensation of all properties owned by Cuban Nationals who had left Cuba. Plaintiffs alternatively claim the loss of the right to receive indemnification as provided by the law of Urban Reform of October 14, 1960, in the amount of Twenty-two thousand four hundred dollars ($22,400.00). The plaintiffs received compensation for eight months before leaving Cuba, leaving the balance due, to which plaintiffs would have been entitled under the Urban Reform Law, of nine years, four months, at Two Hundred dollars ($200.00) per month, or Twenty-two thousand four hundred dollars ($22,400.00).

3. The plaintiffs timely filed a joint income tax return for the calendar year 1961, showing One thousand one hundred sixty-nine dollars ($1,169.00) in gross receipts or gross income and no tax being due or owing.

4. Mr. Cesar Alvarez departed Cuba and entered into the United States on June 6, 1961. Mr. Alvarez became a resident alien of the United States and a United States taxpayer on July 6, 1961, when he declared his intention to stay in the United States and not to return under the visitor's permit with which he had originally entered the country on June 6, 1961.

5. On October 14, 1960, the Revolutionary Government of Cuba enacted the Urban Reform Law. By virtue of the Urban Reform Law, the Cuban Government intervened all urban rental property in Cuba and promised indemnification to the owners and further gave occupying tenants the right to purchase ownership of their apartments by installment payments, contingent on the tenant's

declaration of intent. If a tenant made all the requisite payments, then the tenant would obtain an interest in the property. Said interest did not include the right to convey the interest without approval of the Cuban Government. Plaintiffs' property, located at Avenita des los Martierez No. 66, Comaquez, Cuba, was subject to the provisions of this law. When Mr. Alvarez temporarily left Cuba on June 6, 1961, he did not sustain a loss at that time since the loss was not reasonably certain in fact, and was not ascertainable in amount as a practical matter and in view of a realistic appraisal of all the facts and circumstances as of June 6, 1961. As of that time the Urban Reform Law had only been enacted for a period of approximately eight months. The plaintiffs herein had chosen to receive payments as offered under said Urban Reform Law and had been receiving payments from October 31, 1960, through May 31, 1961, in the amount of Two hundred dollars ($200.00) per month. Thus, the Urban Reform Law, in effect, took nothing from plaintiff and was indemnifying him under his right as claimed by him for property which might sometime in the future become that of anoth but which property, until and including the time of his departure, was still titled in his name.

6. The plaintiff herein chose to temporarily leave Cuba because of the unstable political climate. He had left Cuba many times before to visit his family who lived in the United States, but had always returned to his business in Cuba. Thus, he did not leave because of economic reasons, and had fully intended to return to Cuba. He had every reasonable expectation to be indemnified for the property in Cuba as he was receiving said indemnification and therefore, under Treasury Regulations 1.165-1-(d) (1) and 1.165-1-(d) (2) (i) a loss had not occurred. The facts

of this case indicate that the plaintiffs were reasonable in their expectation that their indemnification which they were receiving for their property as of October 14, 1960, would continue. Their loss took place on December 5, 1961, by virtue of Cuban Statute 989, which confiscated their property without indemnification.

7. The plaintiffs have proven by a preponderance of the evidence that they have suffered a loss from the confiscation of business property located at Avenita de los Martierez No. 66 (Avenue of the Martierez No. 66) Comaguez, Cuba, with a land value of Twenty thousand dollars ($20,000.00) and a building (parking garage and stores) value of Fifty thousand dollars ($50,000.00), for a total loss of Seventy thousand dollars ($70,000.00), of which the plaintiffs owned a one-half interest. Plaintiffs have further proven by a preponderance of the evidence that this property was property used in their trade or business, and that its confiscation resulted in an operating loss under Sections 165(c)(1) and 172(c) and that such loss can be carried forward ten years pursuant to Section 172(b)(1)(D), since they have elected under Section 172(b)(c)(iii).

8. Plaintiff's testimony was believable and uncontradicted and was further corroborated by evidence acquired from the Cuban Judicia, which showed plaintiff was receiving rent on the property in question for Four hundred dollars ($400.00) per month, of which his interest was one-half, which substantiates the fact that plaintiff was entitled to Two hundred dollars ($200.00) per month recompense for the taking of his property in accordance with Cuban Urban Reform Law.

CONCLUSIONS OF LAW

9. For Federal Income Tax purposes, alien individuals are divided generally into two classes, resident aliens and non-resident aliens. Resident aliens are in general taxable in the same manner as citizens of the United States. Treas. Reg. § 1.871-1. The fact that a taxpayer entered the United States on a visitor's visa is not a persuasive indication of his intention at that time, since he was then unable to obtain any other type of visa. Plaintiff was a resident alien at the time the loss occurred. Revenue Ruling 62-197.

10. The plaintiffs did not abandon their property. Abandonment must be clearly proven and the burden of proof is on the party claiming abandonment. It must affirmatively appear that the property or right alleged to have been abandoned has been relinquished by its owner or holder with the intention of abandoning it and with no intention of returning to or reclaiming it.

11. The Internal Revenue Service has recognized that when a person flees a country he does not usually have the time to take with him all of the evidence of ownership. In *Peter v. Elek*, 30 T.C. 731 (1958), the court held that one must use the best available evidence. In *Andrew v. Solt*, 19 T.C. 183 (1952), the Tax Court has applied a reasonable estimate of adjusted basis, citing the familiar Cohan Rule (*Cohan v. Commissioner*, 39 F.2d 540 (2 Cir. 1930)). In the recent case of *Alvary v. United States*, 302 F.2d 790 (2 Cir. 1962), the government conceded that the expropriated property had some value but merely challenged the taxpayer's estimate without offering any of its own evidence. The Court accepted the taxpayer's estimate.

The fact that a plaintiff relies on his own testimony to support his contention in a case does not render the evidence insufficient as a matter of law. *Winter Haven Fruit Sales Corp. v. De Vane*, 120 Fla. 385, 162 So. 909 (1935). Evaluation of evidence is primarily the function of the trier of fact.

12. Losses sustained by an individual are deductible if they are incurred either in his trade or business or in a transaction entered into for profit though not connected with his trade or business. Internal Revenue Code 165(c). Plaintiffs loss, insofar as it resulted from the taking of his right to indemnification, is a loss from the sale or exchange of property in respect of which the right to payment was received. In other words, the character of the loss stems from the nature and character of the asset from which the right to indemnification arose. A close analogy is a loss sustained with respect to an installment obligation, the character of which is derived from the sale or exchange of property in respect of which the installment obligation was received. Internal Revenue Code § 453(d)(1), Treas. Reg. 1.453-9(a).

13. The plaintiffs are entitled to a deduction for loss under Section 165, because they have proved by a preponderance of the evidence:

(a) That they owned the property for which the loss is claimed.

(b) That they did not sustain the loss on the property at or before the time of their departure from Cuba on June 6, 1961.

(c) That they were resident aliens of the United States at the time the property was expropriated.

(d) That the expropriated property was property used in their trade or business, and

(e) That the amount of the loss, which is the adjusted basis of the property at the date the loss occurred, as defined in Section 165(b), converted into United States currency, was Thirty-five Thousand Dollars ($35,000.00).

14. The plaintiffs have established their adjusted basis and are entitled to a business loss which may be carried back and carried forward as a net operating loss in accordance with the provisions of Internal Revenue Code §§ 165, 172, and 1231.

15. Depreciation is not a factor in the instant case. The Court takes judicial notice that any depreciation on this structure allowed or allowable on a straight line basis over a term of fifty years would not reduce the basis of the property below the amount of indemnification plaintiff was to receive from the Cuban Government.

16. Any finding of fact hereinabove made which also constitutes a conclusion of law is adopted as a conclusion of law and any conclusion of law hereinabove made which also constitutes a finding of fact is adopted as a finding of fact.

Counsel for the Plaintiffs is hereby directed to submit an appropriate judgment in conformity with this opinion within five (5) days of the date of the entry hereof.

DONE and ORDERED at Miami, Florida, on this 20th day of June, 1969.

EMETT C. CHOATE

SENIOR UNITED STATES DISTRICT JUDGE